

Message Text

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ACTION EB-11

INFO OCT-01 NEA-10 ADP-00 AID-20 CIAE-00 COME-00 FRB-02

INR-10 NSAE-00 RSC-01 TRSE-00 XMB-07 OPIC-12 CIEP-02

LAB-06 SIL-01 OMB-01 NSC-10 SS-15 STR-08 CEA-02 AGR-20

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E.O. 11652: N/A

TAGS: EFIN, ECON, CE, IMF

SUBJ: IMF STAND-BY FOR SRI LANKA

REF: STATE 132122

1. DURING MY JULY 16 MEETING WITH PRIME MINISTER BANDARANAIKE (OTHER SUBJECTS REPORTED SEPTELS), I ASKED HER ABOUT PRESS REPORT THAT FINANCE MINISTER N M PERERA WAS GOING TO WASHINGTON TO NEGOTIATE \$25 MILLION STAND-BY AGREEMENT WITH IMF. PM REPLIED PERERA WOULD BE IN WASHINGTON AT END OF MONTH FOR MEETING OF COMMITTEE OF TWENTY AND PLANNED TO SEE IMF PRESIDENT SCHWEITZER AT THAT TIME ON STAND-BY QUESTION.

2. BOTH PLANNING SECRETARY GUNASEKERA AND DIRECTOR FOREIGN RESOURCES KAPPAGODA, ALSO PRESENT DURING MEETING, THEN PROCEEDED TO EXPLAIN IMF'S NEGATIVE ATTITUDE DURING THEIR RECENT VISIT TO WASHINGTON. THEY SAID THAT, ACCORDING TO IMF THEOLOGY, A COUNTRY SHOULD NOT BE ELIGIBLE FOR THIRD CREDIT TRANCHE UNLESS IT UNDERTOOK SUBSTANTIAL EXCHANGE RATE ADJUSTMENTS.

AS FIRST PREFERENCE, IMF HAD PRESSED GSL TO MAKE ACROSS-THE-BOARD DEVALUATION BY ADOPTION FEEC RATE AS OFFICIAL RATE. AS SECOND ALTERNATIVE, IMF WANTED GSL TO SHIFT THREE BASIC EXPORT

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COMMODITIES, TEA, RUBBER AND COCONUTS TO FEEC SYSTEM. OVERALL

DEVALUATION WOULD CAUSE UNDESIRABLE POLITICAL REPERCUSSIONS AND WOULD NOT ACHIEVE ANTICIPATED ECONOMIC RESULTS. SAME WAS TRUE FOR PROPOSED INCENTIVES AFFECTING BASIC EXPORT COMMODITIES. GSL WAS PLANNING PROVIDE FERTILIZER SUBSIDY FOR TEA INDUSTRY WHICH WOULD REDUCE PRODUCTION COSTS BY 5PERCENT AND THIS WAS BETTER APPROACH THAN EXCHANGE RATE ADJUSTMENT. BECAUSE OF CURRENT HIGH PRICES FOR RUBBER, EXCHANGE RATE ADJUSTMENTS WOULD NOT SIGNIFICANTLY ENHANCE RUBBER EXPORTS. IN CASE OF COCONUTS, IT WAS MATTER OF INCREASING PRODUCTION, WHICH HAD SUFFERED BECAUSE OF DROUGHT, AND THEREBY RESTORING PREVIOUS EXPORT LEVELS.

3. REINFORCING GUNASEKERAS AND KAPPAGODAS COMMENTS
RE POLITICAL PROBLEMS, PM SAID IMF DID NOT APPRECIATE DIFFICULT STEPS GSL HAD TAKEN SINCE LAST BUDGET TO GENERATE ADDITIONAL RESOURCES. PROBLEM WAS BENEFITS OF THESE ADDITIONAL FUNDS WERE WIPED OUT BY SHARP INCREASE IN IMPORT PRICES AND ADVERSE FLUCTUATIONS IN INTERNATIONAL MONETARY SYSTEM. RECENT DEDIGAMA ELECTION WAS LARGELY SYMPATHY VOTE FOR DUDLEY SENANAYAKE BUT IT ALSO REFLECTED VOTER DISSATISFACTION WITH TOUGH ECONOMIC DECISIONS TAKEN BY GSL. THERE WAS LIMIT BEYOND WHICH GSL COULD NOT GO AND IMF SHOULD RECOGNIZE REALITY OF SITUATION RATHER THAN ADHERE TO TRADITIONAL PROCEDURES.

4. MRS BANDARANAIKE CONCLUDED BY INDICATING SHE DID NOT ANTICIPATE N M PERERA WOULD BE SUCCESSFUL BUT SHE NONETHELESS HOPED THERE MIGHT BE SOME MELLOWING IN IMF'S NEGATIVE ATTITUDE. SHE ALSO HALF WHISPERED THAT SHE BELIEVED IMF'S ATTITUDE STEMMED FROM BRITISH PRESSURE ON IMF ON BEHALF BRITISH PLANTATION INTERESTS WHICH HOPED THEY WOULD BENEFIT FROM EXCHANGE RATE PROPOSALS BEING ESPOUSED BY IMF. I TOOK THIS OPPORTUNITY TO ASSURE PM THAT USG WOULD BE PREPARED TO SUPPORT STAND-BY AGREEMENT WHICH MET IMF CRITERIA, ALTHOUGH WE COULD NOT MAKE ANY SPECIFIC COMMITMENT UNTIL WE EXAMINED POLICY ISSUES WHICH MIGHT BE INVOLVED. LEST THERE BE ANY MISUNDERSTANDING, I ALSO RECALLED THAT US EXECUTIVE DIRECTOR HAD SUPPORTED SRI LANKA COMPENSATORY FINANCING DRAWINGS WHEN THIS ISSUE HAD BEEN CONSIDERED BY IMF BOARD.
VAN HOLLEN

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